

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

DOCKET NO. 2001-181-W - ORDER NO. 2001-1103

JANUARY 8, 2002

IN RE:	Application of Dowd Water Systems, Inc.)	ORDER ESTABLISHING
	Requesting Approval of the Establishment of)	RATES AND CHARGES
	Rates and Charges for Emerald Shores and)	FOR TWO WATER
	Isle of Pines in Lexington County.)	SYSTEMS

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This matter comes before the Public Service Commission of South Carolina (the Commission) on the Application of Dowd Water Systems, Inc. (Dowd or the Company) requesting approval of the establishment of water rates and charges for the Emerald Shores and Isle of Pines subdivisions in Lexington County, South Carolina.

Pursuant to the instructions of the Commission's Executive Director, the Company published a Notice of Filing, one time, in newspapers of general circulation in the Company's service area, and served a copy of said Notice on all affected customers in the service area. The Company furnished affidavits to show that it had complied with the instructions of the Executive Director. No Protests or Petitions to Intervene were received.

Accordingly, a hearing was held on October 24, 2001 at 10:30 AM in the offices of the Commission, with the Honorable William Saunders, Chairman, presiding. Dowd was represented by David Knight, Esquire. The Company presented the testimony of Sue Dowd and D. Joe Maready. The Commission Staff was represented by F. David Butler, General Counsel. The Staff presented the testimony of Johnny T. Johnson, P.E.

(subpoenaed), Steve W. Gunter and Charles A. Creech. Various public witnesses also appeared. David Price of the South Carolina Department of Health and Environmental Control (DHEC) also appeared.

Sue Dowd testified on behalf of the Company. Mrs. Dowd stated that she is the owner and manager of Dowd Water Systems, Inc. of which Emerald Shores and the Isle of Pines are divisions. The systems were left to Mrs. Dowd through her late husband's estate in February 2000.

Mrs. Dowd noted that the Isle of Pines is a subdivision with five (5) full time residents and fifteen (15) part time residents. It has one well to serve each homeowner potable water for a monthly flat fee of \$12.00. Emerald Shores has seventeen (17) full-time customers. There are two wells which also furnish potable water at a monthly flat fee \$20.00 per month. This system has a water storage tank that holds approximately 12,000 gallons of water. Mrs. Dowd has not heretofore come before this Commission to obtain Certificates of Public Convenience and Necessity for these systems. Mrs. Dowd is requesting certification of the two water systems, with a flat rate of \$25.00 per month for part-time customers and \$35.00 per month for full-time customers in the Isle of Pines subdivision. For Emerald Shores, Mrs. Dowd is requesting a flat rate of \$62.00 per month. Mrs. Dowd is also requesting a disconnect fee of \$90.00 and a reconnect fee of \$90.00. Mrs. Dowd states that she has a contract with a plumbing company that will meet her at the site to excavate the distribution pipe and disconnect the water service at a charge of \$75.00. The same company will also meet her to reconnect the water service.

Mrs. Dowd proposes \$15.00 as the cost of her time for each trip, for a total of \$90.00 for disconnect and \$90.00 for reconnect.

D. Joe Maready, an accountant, also testified on behalf of the Company. Maready noted that he used a test period of the twelve (12) months ending December 31, 2000. Maready stated that the current monthly charges in Emerald Shores of \$20.00 per month for 17 customers produce revenues of \$4,080 for the year. After operating expenses of \$5,250, the Company lost \$1,170 for an operating margin of (28.68%). After proposed expenses for known and measurable changes, operating margin increases to (107.21) %. The Company is requesting a monthly charge of \$62.00 per month for unlimited usage of water. The increase of \$42.00 per month on 17 customers produces a proposed increase of \$8,568 and an operating margin of 26.26%.

With regard to the Isle of Pines, Maready utilized the same test period. The Company was charging \$12.00 per month for water service in this subdivision. At \$12.00 per month on 20 customers, revenue was \$2,880 for the test year. Total expenses, according to Maready were \$1,072 producing an operating margin of 62.78%. After pro forma and accounting adjustments for known and measurable changes, the result is an operating margin of (3.85) %. The Company is requesting \$35.00 per month for the five (5) full-time customers and \$25.00 per month for the 15 part-time customers. This results in a proposed increase of \$3,720. After the proposed increase, operating margin is 43.64%. (The total proposed increase combined for both systems is \$12,288.)

Steve W. Gunter, an accountant in the Audit Department, testified on behalf of the Commission Staff. Gunter also utilized a test year of the twelve months ending

December 31, 2000. Gunter proposed seven accounting and proforma adjustments and one adjustment for the proposed increase. In adjustment #1, both Staff and the Company propose to adjust testing fees for the effect of switching the responsibility of testing to an outside contractor, effective April 1, 2001. The Staff and the Company's adjustment allocated this cost to Emerald Shores Subdivision based on the number of customers in the Stephenson's Lake and Emerald Shores Subdivisions, the two subdivisions covered under the contract. Allocation based on number of customers is more representative of the actual cost to be incurred by each subdivision. The total annual contract amount was \$13,236 of which 60.98% was allocated to Stephenson's Lake and 39.02% to Emerald Shores. The computation resulted in an assignment of \$5,165 to Emerald Shores for testing fees. Staff then eliminated per book amounts totaling \$2,486 for testing fees. The net adjustment totaled \$2,679.

In Gunter's second adjustment, Staff and the Company proposed to adjust testing fees for the effect of switching the responsibility to an outside contractor, effective in 2001 for the Isle of Pines subdivision. A \$305 increase in testing fees is a known and measurable expense, according to Gunter. Gunter's third adjustment proposes a reduction in Operating and Maintenance Expenses of the Emerald Shores Subdivision for a major pump repair occurring during the test year. Staff proposes to capitalize this expenditure and depreciate the cost over the pump repair's useful life of ten years.

For the fourth adjustment, Staff and Company propose to depreciate the cost of a major pump repair occurring outside the test year for the Emerald Shores subdivision. The Staff proposes to capitalize and depreciate the repair over its useful life of ten years

while the Company proposes to amortize the cost over three years. For the fifth adjustment, the Company proposes to amortize the cost of replacing a pump which was damaged when the county damaged water lines causing the pump to over heat and burn-up. The Company proposes to amortize the cost of the pump over two years and the cost to repair the water lines over three years. The Staff understands that these costs may be reimbursed by the county. Under this condition, Staff does not believe that such costs should be recovered from the Company's ratepayers if such costs are to be reimbursed.

For the sixth adjustment, Staff and Company propose to amortize rate case expenses over three years. This has the effect of normalizing the test year. For the seventh adjustment, the Staff and the Company propose to true-up the gross receipts tax assessment imposed by this Commission. The Staff and the Company differ, due to Staff's use of a more up-to-date factor in the calculation. In the eighth adjustment, Staff and the Company show the effect of the proposed increase in rates. The updated gross receipts tax factor was used by the Staff in computing Taxes Other Than Income Taxes. Staff's income tax calculation was based on taxable income after the Staff's adjustments.

In summary for Emerald Shores, Gunter found \$4,080 in total operating revenues and \$5,250 in total operating expenses for the test year, or a (\$1,170) net income return. This results in a (28.68%) operating margin for the test year per books. After accounting and proforma adjustments, Gunter calculated a net income for return of (\$2,572) or a (63.04%) operating margin. The proposed net income for return after the increase is \$4,764, which results in a 37.67% operating margin.

In summary for Isle of Pines, Gunter found \$2,880 in total operating revenues and \$1,072 in total operating expenses for the test year, or a \$1,808 net income for return. This results in a 62.78 % operating margin for the test year per books. After accounting and proforma adjustments, Gunter calculated a net income for return of \$1,427 or a 49.55% operating margin. The proposed net income for return after the increase is \$4,122, which results in a 62.45% operating margin. If one looks at a combined operating margin for Emerald Shores, Isle of Pines, and Stephenson's Lake, the margin would be 36.33%.

Charles A. Creech testified on behalf of the Utilities Department of the Commission Staff. Creech noted that the water systems in Emerald Shores and Isle of Pines were installed in the late 1960s and early 1970s. Creech states that Emerald Shores has 17 full-time customers. As Creech notes, the currently charged rate, which has not been approved by the Commission, is \$20.00 flat rate per month. The requested rate is \$62.00 flat rate per month. This would amount to a \$42.00 per month increase. Creech stated that the Isle of Pines subdivision consists of 20 customers, 5 being full time and 15 part time. The currently charged rate, which has also not been approved by the Commission, is \$12.00 flat rate per month for all customers in that area. In the present Application, the Company is requesting \$35.00 per month for full time customers and \$25.00 for part time customers. Creech reported that Staff had received 4 letters in opposition to the rate increase proposal for Emerald Shores, and none with regard to the Isle of Pines. Upon questioning from Commissioners, Creech noted that both Emerald Shores and the Isle of Pines received unsatisfactory sanitary surveys from DHEC. Mrs.

Dowd was given a list of items to be addressed to attempt to resolve the matter of the unsatisfactory surveys. This list and a discussion of the problems are contained in a letter from DHEC submitted as a part of the Companies' applications in this matter. Further, in response to a question by Commissioner Atkins, Creech testified that the rate increase proposed for the two systems would most likely not result in future compliance with the DHEC regulations.

Morris Dunn, a resident of the Isle of Pines subdivision, testified as a public witness. Dunn stated that he and the other Isle of Pines residents are willing to form a homeowners association to take over the water system in the subdivision. Dunn stated that the purpose of the association's taking over the system would be to hook onto the City of Chapin water service. Dunn sought this Commission's assistance in this endeavor. According to Staff witness Creech, Mrs. Dowd had agreed to give the Isle of Pines water system to the proposed homeowners association.

Johnny T. Johnson, P.E. testified under subpoena from the Commission Staff. Johnson presented a preliminary cost estimate to extend water from the City of Chapin to the Isle of Pines subdivision. Johnson stated that the total cost of the extension would be \$103,250, which would include installing new lines within the Isle of Palms subdivision and fire hydrants within 500 feet of each house.

David Price of DHEC appeared. His testimony shows apparent non-compliance with DHEC regulations. It appears that both Emerald Shores and Isle of Pines have a number of compliance issues under DHEC rules and regulations that must be addressed.

FINDINGS OF FACT

1. Dowd Water Systems, Inc. is a water utility under the jurisdiction of the Commission. Dowd seeks to establish rates and charges for the Emerald Shores and Isle of Pines subdivisions in Lexington County, South Carolina.

2. The water systems in Emerald Shores and Isle of Pines were installed in the late 1960's and early 1970's.

3. The Emerald Shores water system consists of 17 full-time customers. The Isle of Pines water system consists of 20 customers, 5 being full-time and 15 part-time.

4. The Emerald Shores current non-approved rate is \$20.00 flat rate per month. The requested rate is \$62.00 flat rate per month. The Isle of Pines current non-approved rate is \$12.00 flat rate per month for all customers on that water system. The Company is requesting \$35.00 per month for full-time customers, and \$25.00 per month for part-time customers.

5. The Commission Staff's accounting adjustments should be adopted in toto for the reasons stated in the testimony and exhibits of Staff witness Gunter.

6. The testimony presented justifies our establishing flat rates as follows: Isle of Pines-full-time residents-\$35.00 per month; Isle of Pines-part-time residents-\$25.00 per month; Emerald Shores-\$35.00 per month.

7. This rate structure provides additional annual revenue of \$6,780 and an operating margin of 32.67%. Total combined operating revenue will be \$13,740.

8. The annual Sanitary Surveys conducted by DHEC on March 22, 2001 resulted in an unsatisfactory rating for both water systems. A rating of unsatisfactory was

given due to the fact that the deficiencies from the previous survey of September 6, 2000, had not been corrected.

9. Dowd is required to immediately begin the process of transferring the water systems serving the Isle of Pines and Emerald Shores to other viable entities.

10. A status report shall be filed by Mrs. Dowd within 3 months from the date of this Order related to the transfer of the Isle of Pines System, and within 6 months related to the transfer of the Emerald Shores system.

CONCLUSIONS OF LAW

1. The Company's operation in South Carolina is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. Section 58-5-10, et seq. (Supp. 2000).

2. The Commission concludes that each of the Staff's adjustments proposed by the Commission Staff is appropriate and each is hereby adopted by the Commission based on Staff witness Gunter's stated reasoning as noted above.

3. We hereby grant establishment of both the Emerald Shores and Isle of Pines water systems, and grant a Certificate of Public Convenience and Necessity for each system. However, we are imposing certain conditions on the granting of this authority. First, we are requiring the owner, Mrs. Dowd, to immediately begin the process of transferring the water systems serving the two subdivisions to a viable entity. It is clear from the testimony presented that compliance with DHEC regulations is a major question. Second, the Company must file status reports within three (3) months from the date of this Order related to the transfer of the Isle of Pines system, and within six (6) months of the date of this Order related to the transfer of the Emerald Shores system.

4. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rate of a public utility. For a water utility whose rate base has been substantially reduced by customer donations, tap fees, contributions in aid to construction, and book value in excess of investment, the Commission may decide to use the “operating ratio” and/or “operating margin” method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the total operating income for return by the total operating revenues of the utility. The Commission concludes that the use of the operating margin is appropriate in this case.

5. The Commission is mindful of the need to balance the respective interests of the Company and of the consumer. It is incumbent upon this Commission to consider not only the revenue requirement of the Company, but also the proposed price for the water, the quality of service, and the effect of the proposed rates upon the consumers.

6. Based upon all of these considerations, the Commission determines that the Company should have the opportunity to earn a 32.67% operating margin on its regulated water operations in the Isle of Pines and Emerald Shores subdivisions combined. In order to have a reasonable opportunity to earn a 32.67% operating margin, the Company will need to produce \$6,780 in total additional annual operating revenues.

TABLE A

OPERATING MARGIN

Operating Revenues	\$13,740
Operating Expenses	<u>9,251</u>
Net Income for Return	<u>4,489</u>
Operating Margin	<u>32.67%</u>

1. In order to earn the operating revenues necessary to earn an operating margin of 32.67%, the Company must earn total revenues of \$13,740. In order to earn these revenues, we hold that flat rates on the systems shall be granted as follows and as appear in Appendix A attached to this Order: Isle of Pines-full time-\$35 per month; Isle of Pines-part time-\$25 per month; Emerald Shores-\$35 per month.

2. We also approve the proposed disconnect and reconnect fees of \$90 each, as was justified by the testimony.

3. Accordingly, it is ordered that the rates attached in Appendix A are hereby approved for service rendered on or after the date of this Order.

4. It is ordered that if the approved schedule is not placed in effect within three (3) months after the date of this Order, the approved schedule shall not be charged without written permission of the Commission.

5. It is further ordered that the Company maintain its books and records for Emerald Shores and Isle of Pines and its books and records in general for water operations in accordance with the NARUC Uniform System of Accounts for water utilities as adopted by this Commission.

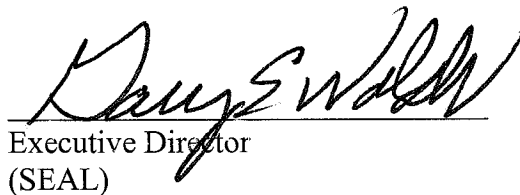
6. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:



Chairman

ATTEST:


Executive Director
(SEAL)

Concurring Opinion of Commissioner James Blake Atkins

The establishment case for the Dowd Water Systems, Inc. (Emerald Shores and Isle of Pines), and in particular the findings set forth in this Order, represent a unique occurrence in such cases before the Commission. Within the institutional memory of the Commission, a water system has never been established and also ordered to transfer their system within the same Order. Clearly, the Commission had to exert its jurisdiction over these systems to subsequently "order" transfer to a viable system(s). Consistent with S.C. Code Ann. Section 58-5-730 (1976), the Commission, in principle, concluded that Dowd, a utility subject to the regulations of the Commission, had willfully failed to provide adequate and sufficient service for an unreasonable length of time and was likely to continue such failure to the detriment of the public served by the utility.

Establishment cases are intended to be applicable to "new" systems, or changes to the existing rates of an approved system. However, as mentioned above, the water systems in Emerald Shores and Isle of Pines were installed in the late 1960s and early 1970s. Until the Commission's records were cross-referenced with those of DHEC during mid-2000, these systems were unregulated by the Commission. This discovery exemplifies the need for timely and accurate coordination with DHEC regarding jurisdictional water systems under the Commission's regulations. Such coordination and data sharing is now becoming the standard practice of Commission staff.

In order to accept the applications in this case, a number of waivers were granted by the Commission. The waivers exempted Dowd from filing information regarding engineering plans and specifications, a Construction Permit from DHEC, a financial statement showing plant investment by category, a plant depreciation schedule, and a statement by a professional engineer of the "adequate installation" of the system. These waivers were a clear and unambiguous indication of the compliance problems which became evident during the hearing. Further, the unsatisfactory overall ratings for the systems on the March 22, 2001 DHEC sanitary surveys reveal a host of operational and infrastructure compliance issues. Individual unsatisfactory ratings were observed for protection of the wells from contamination, lack of valve maintenance, an inadequate flushing program, an inadequate leak detection program, inadequate maintenance and security regarding the water storage tank, and lack of records concerning operating records logs. All of these are critical service quality issues.

Cumulatively, the waivers granted by the Commission and the overall unsatisfactory ratings by DHEC unambiguously demonstrate noncompliance with the Commissions regulations. Specifically, 26 S.C. Code Ann. Regs. 103-740 (1976) requires a utility to operate and maintain in safe, efficient and proper conditions all of its facilities and equipment used in connection with the services it provides to any customer. Additionally, 26 S.C. Code Ann. Regs. 103-750 (A) (1976) requires the water plant of the utility to be constructed, installed, maintained and operated in accordance with accepted good engineering practice and regulations. 26 S.C. Code Ann. Regs. 103-770(A)(1976) requires each utility to provide water that is potable and insofar as practicable, free from objectionable odor, taste, color and turbidity. Each utility **must also comply with all laws and regulations of the State** and local agencies pertaining to water service. Lastly, 26 S.C. Code Ann. Regs. 103-770(B)(2)(a) (1976) requires that the operation of the water supply system, including wells, reservoirs, pumping equipment, treatment and filtration works, mains, meters, and service pipes shall be free from sanitary defects. The evidence presented in this case demonstrated that these two systems have not complied with these regulations since September 6, 2000.

It is also important to understand the role and contribution of DHEC in this matter. The Commission must fully consider the facts and evidence available from DHEC, as well as the DHEC regulatory requirements regarding drinking water systems. 26 S.C. Code Ann. Regs. 103-751_(1976) requires that each utility shall use the guideline of DHEC as minimum standards of good engineering practices. Here, engineering practices must be interpreted broadly, encompassing design, construction, operation and

maintenance of the water system. It is important that the Commission consider all facts which in its judgment have a bearing upon a proper determination of the question, although not set forth in the application. Given the directive found in 26 S.C. Code Ann. Regs. 103-751 (1976) it is difficult, as a finder of fact, to make an informed decision without insight into the DHEC files concerning a system. To that end, it is imperative that, in future hearings dealing with water or wastewater utilities, the Commission staff review the DHEC files regarding the system in question, and that any relevant data be presented and entered into the evidence of the hearing. Direct testimony from DHEC staff regarding the case would also provide additional knowledge and clarification.

Regarding rates, it is the responsibility of the Commission to regulate the rates and service of every public utility in this State. Further, under S.C. Code Ann. Section 58-5-240(H)(Supp. 2001), the Commission's determination of a fair rate of return must be documented fully in its findings of fact and based exclusively on reliable, probative, and substantial evidence on the whole record. The Commission shall specify an allowable operating margin in all water and wastewater orders. In this case, the rate at Emerald Shores was proposed to increase from \$20.00 per month to \$62.00 per month. For the Isle of Pines, rates of \$35.00 per month for full-time customers, and \$25.00 per month for part-time customers were requested. The current non-approved rate is \$12.00 flat rate per month for all customers in Isle of Pines. Following the required adjustments by Gunter, these proposed rates would have resulted in operating margins 37.67% and 62.45% for Emerald Shores and Isle of Pines, respectively. The combined operating margin for Emerald Shores, Isle of Pines, and Stephenson's Lake would have been 36.33%.

Commissioner Atkins questioned Gunter concerning the reasonableness of these operating margins compared to other water systems. Clearly, an operating margin of 62.45% and a rate of \$62.00 per month were not determined to be reasonable by the Commission. It is important that water systems be provided an opportunity to earn an adequate operating margin to allow viable operation and maintenance of the system. However, given the historical evidence and prospect of continued non-compliance of these systems, such a large operating margin, in particular for the Isle of Pines, is a bad investment for the water customers. In addition, a rate of \$62.00 per month borders on rate shock, in particular when customers testified that they had to purchase bottled water for drinking due to the poor quality of the existing systems.

As stated in the Conclusions of Law section above, the Commission is mindful of the need to balance the respective interests of the Company and of the consumer, and must consider not only the revenue requirement of the Company, but also the proposed price for the water, the quality of service, and the effect of the proposed rates upon the consumers. In making this decision, the Commission considered and analyzed all the evidence presented, both in written and oral testimony, which had a bearing upon a proper determination of the question, and not just the information set forth exclusively in the application.


James Blake Atkins, Ph.D.

DOCKET NO. 2001-181-W – ORDER NO. 2001-1103
JANUARY 8, 2002
APPENDIX A

Dowd Water Systems, Inc.
Sue Dowd
77 Dowd Road
Prosperity, SC 29127
803-345-2285

EMERALD SHORES

Monthly Flat Rate - \$35.00
Disconnect Fee - \$90.00 *
Reconnect Fee - \$90.00 *

ISLE OF PINES

Monthly Flat Rate – Full Time Residents - \$35.00
Monthly Flat Rate Part-Time Residents - \$25.00
Disconnect Fee - \$90.00 *
Reconnect Fee - \$90.00 *

* \$75.00 Contract Cost, plus \$15.00 mailing and travel by owner